Totens Sparebank Boligkreditt

Norwegian Mortgage Covered Bonds – Performance Update

Rating rationale (summary)

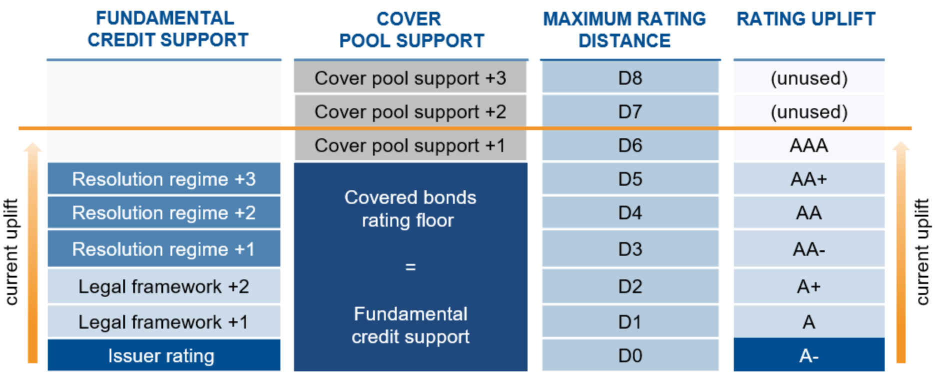
The AAA ratings with a Stable Outlook on the Norwegian covered bonds (obligasjoner med fortrinnsrett) issued by Totens Sparebank Boligkreditt (TSBB) are based on the bank's issuer rating of A-, enhanced by six notches of cover pool support. Five additional notches reflect the strong fundamental credit support provided by the Norwegian legal covered bond and resolution frameworks.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 June 2019	NOK 2.76bn	Residential mortgage loans	NOK 2.28bn	AAA/Stable

TSBB is a wholly owned, specialised credit institution dedicated to providing secured covered bond funding for its parent, Totens Sparebank (TSB). Our A- issuer rating on TSBB reflects its full ownership by TSB (A-) and its ability to refinance residential mortgage loans using covered bonds.

Fundamental credit support factors from the Norwegian legal and resolution framework provides a five-notch uplift above the bank's rating. This effectively forms a rating floor at AA+. Cover pool support enables the programme to be rated AAA, considering another one-notch uplift reflecting the credit strength of the covered bond programme.

The programme may further benefit from a buffer of two notches against an issuer downgrade as the maximum theoretical uplift constitutes eight notches, as opposed to the six notches used to achieve highest rating for these covered bonds.



Stable Outlook

The Stable Outlook on the covered bond rating reflects our expectations that: i) the credit performance of TSB, TSBB and its mortgage borrowers will continue to be stable; ii) the issuer will maintain the prudent risk profile of its covered bond programme; and iii) both the parent and direct issuer will remain willing and able to provide sufficient overcollateralisation to support the covered bond's very strong credit quality.

Changes since the last performance update

Since September 2018 the cover pool has increased to NOK 2.76bn (+15%). This was mainly driven by asset reallocation from mortgage loans otherwise registered into the EIKA covered bond programme. Relevant risk metrics such as the loan-to-value ratio, the remaining term and the loan's default expectation have remained stable. Maturity mismatches have reduced via the issuance of longer-dated bonds (4-5 years).

Ratings & Outlook

Covered bond rating	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action date	16 Oct. 2019
Issuer rating	**A-**
Outlook	Stable
Last rating action	New Rating
Last rating action date	30 Oct. 2018

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Related Research

Scope affirms the mortgage-covered bonds issued by TSBB, 16 October 2019

Totens Sparebank Boligkreditt Mortgage Covered Bonds Rating Report, 30 October 2018

Totens Sparebank Issuer Rating Report,30 October 2018

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The issuer

The issuer ratings of TSBB reflect those of its parent bank, TSB.

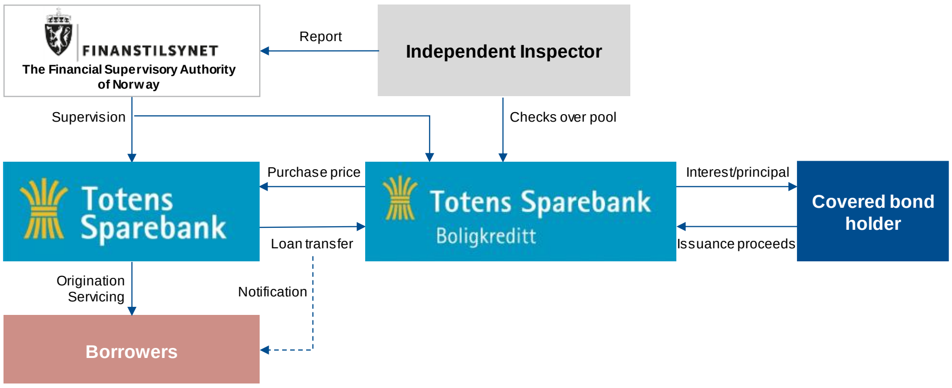
Established in 1854, TSB is a savings bank with a strong market position in south-eastern Norway. Macroeconomic conditions in Norway are supportive, with the country having recovered from a fall in oil prices in 2014. The bank operates primarily in the Mjos region, where agriculture, manufacturing and the public sector are important industries. Over 70% of the bank's lending concerns residential mortgages.

For further details on our bank credit analysis see the full bank rating report available on www.scoperatings.com.

Programme structure

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the Financial Institutions Act and a related regulation on mortgage credit institutions, both introduced in 2007. Under this framework, issuance is permitted only through specialist covered bond issuers. Like TSBB, most issuers of covered bonds (generally called Boligkreditt, or specialised residential mortgage institutions) are subsidiaries that rely on loans originated by their respective parent banks. The parent banks generally also provide most of the services for these subsidiaries, allowing the latter to keep staff numbers low.

Issuance structure



Source: Scope Ratings

Fundamental credit support analysis

Fundamental credit support factors enhance the covered bond rating by five notches above TSBB's issuer rating. This is based on our view of: i) Norway's covered bond legal framework; and ii) the resolution regime and systemic importance of TSBB's covered bonds.

Two notches of uplift based on legal framework analysis…

We view the Norwegian covered bond framework to be one of Europe's strongest, meeting our criteria for protecting investors. Therefore, we assign the highest credit differentiation of two notches.

… on top three notches of uplift reflecting resolution regime and systemic importance

TSBB's covered bonds benefit from an additional three-notch uplift that reflects their exemption from bail-in and the support from a strong stakeholder community. We reflect the combination of: i) a moderate to high likelihood that the covered bond issuer will be maintained in a resolution scenario; and ii) the high systemic importance of covered bonds in Norway. However, we also recognise the low visibility and importance of TSBB as a covered bond issuer. Generally, we provide four additional notches of support for Norwegian covered bonds issued by resolvable and very visible entities. For more information, see the related research.

Pool characteristics

Reporting date	June 2019	Sept 2018
Balance (NOK bn)	2.76	2.08
Residential (%)	91.4	90.8
Substitute (%)	8.6	9.2

Property type (%)

Reporting date	June 2019	Sept 2018
Single-family house	71.0	72.0
Apartment	11.6	11.0
Shares*	9.3	8.9
Holiday home	4.0	4.1
Others	4.1	4.0

*Shares in housing association

General information

Reporting date	June 2019	Sept 2018
No. of loans	1,713	1,452
Avg. loan size (NOK m)	1,5	1.4
Top 10 (%)	2.9	3.9
Remaining life (years)	12.5	12.2
LTV (%)	55.2	53.1

Interest rate type (%)

Reporting date	June 2019	Sept 2018
Floating	100	100
Fixed	0	0

Repayment type (%)

Reporting date	June 2019	Sept 2018
Bullet	0	0
Amortising	100	100

Cover pool analysis

We have established that an overcollateralisation of 4% can mitigate identified credit and market risk stresses and support the uplift under our rating methodology.

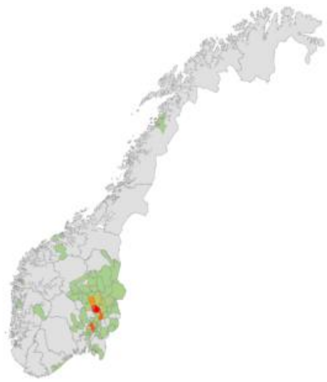
This represents a drop in rating-supporting overcollateralisation since the last analysis based on September 2019 data (from 8%), mainly driven by a methodological alignment of our market value haircuts, resulting in an effective reduction in stressed haircuts by 2%-3%, and by our criteria update introducing interest paid on the cash account in our cash flow analysis. The latter has changed the programme's worst-case scenario from a low to a high prepayment scenario, positively impacting supporting overcollateralisation.

Cover pool composition

The cover pool is predominantly secured by Norwegian residential mortgage loans denominated in Norwegian krone. The cover pool also comprises substitute assets, mainly other highly rated Norwegian covered bonds. The bank operates primarily in the Mjos region in south-eastern Norway, namely Oppland (44%), Akershus (26%), Hedmark (15%) and Oslo (11%) as of June 2019.

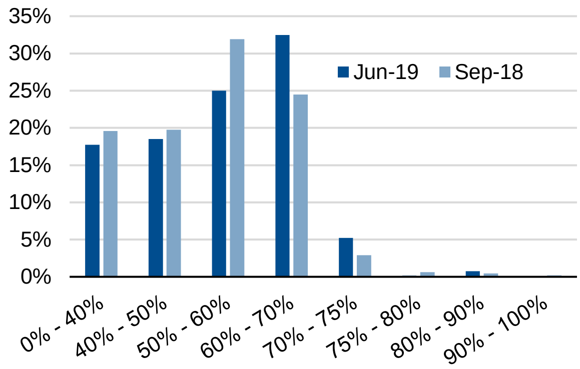
The mortgage pool consists of 1,731 loans granted to 1,671 obligors with an average loan size of NOK1.47m. The largest obligor only accounts for 0.4%. Since our last review, granularity has improved, reflecting the mortgage portfolio's growth by 15%.

Regional distribution



Source: Scope Ratings, TSBB

LTV distribution (indexed)



Source: Scope Ratings, TSBB

Most of TSBB's cover pool continues to be backed by mortgage loans to residential borrowers secured by single-family houses (72%), followed by apartments and shares in housing associations. The loan-to-value was 55%, an increase by 2pp since the last review, which was also driven by the 15% top-up of new loans into the portfolio.

Asset risk analysis

Strong credit quality translates into low credit risk

The credit quality of the cover pool remains strong and is generally unchanged since last year's analysis. Recovery rates have improved, mainly driven by our revisions to security value haircuts.

Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on available credit performance data provided by the bank (in particular, probability-of-default back-testing) and benchmarking. Due to the stable asset performance, we have maintained our assumptions of an effective weighted-average lifetime mean default rate of 9.5% and on the asset's volatility of default (weighted average coefficient of variation) of 50%.

For the mortgage loans we estimate a weighted average recovery rate of 97.4% (from 99%) under a base case and 77.7% (from 66.5%) under the most stressful scenario.

The base case rate is supported by the portfolio's low average loan-to-value; the stressed rate is driven by the relatively high share of prior liens. The prior liens result from senior claims pledged to Eika Boligkreditt, the secured funding platform used by TSB in tandem to its own.

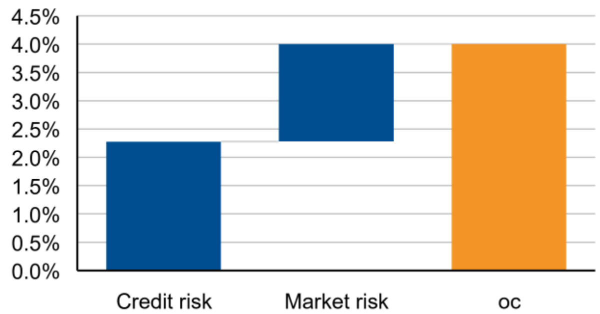
We also analysed the credit risk of the substitute assets. The average lifetime mean default rate was 0.21% with a very high coefficient of variation (90%) and a recovery rate of 60%. Our projections of default on substitute assets follows a non-parametric distribution calculated using a Monte Carlo analysis.

Cash flow risk analysis

Credit risk main contributor to supporting overcollateralisation

The cover pool is mainly exposed to credit risk, which accounts for 2.3pp of the rating-supporting overcollateralisation. Despite credit risk being the main driver of supporting overcollateralisation, it remains low on an absolute level, reflecting the strong credit quality of the pool.

Figure 1: Components of rating-supporting overcollateralisation



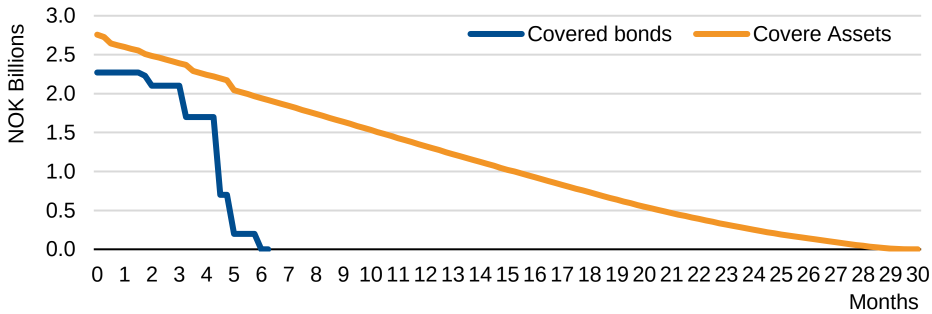
Source: Scope Ratings

Market risk from cost of carry driving high prepayment scenario

Market risks, mainly asset-liability mismatches, account for 1.7pp of rating-supporting overcollateralisation. However, given the programme is most exposed to a high prepayment scenario, overcollateralisation is driven by cost of carry as excess cash bears no margin. Asset sales do not drive the supporting overcollateralisation due to the high prepayment scenario.

Maturity mismatches have generally improved since the last analysis, via the issuance of as additional bonds with longer maturities. 75% of the current outstanding covered bonds were issued after September 2018. This has raised their weighted average remaining term to around 4.1 years from 2.6 years; both figures consider the one-year extension option.

Figure 2: Amortisation profile



Source: Scope Ratings, TSBB

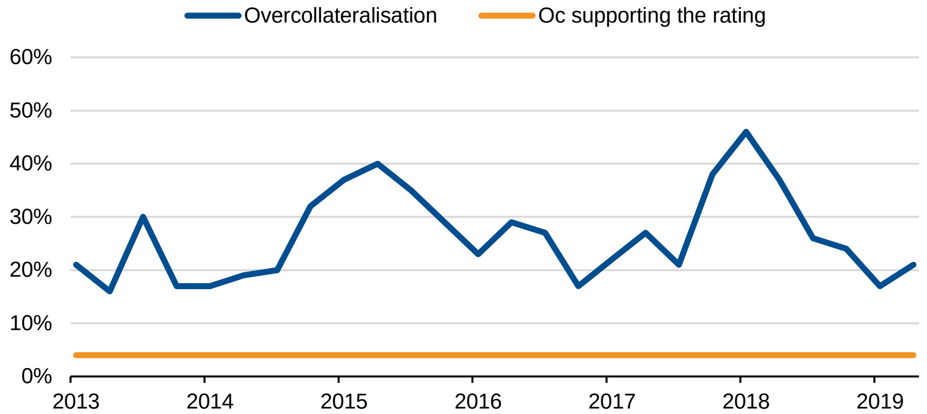
There is no foreign exchange risk as assets and liabilities are denominated in Norwegian krone. At this stage we do not expect any foreign currency-denominated issuances.

Availability of overcollateralisation

Overcollateralisation fully taken into account

The current rating of TSBB allows us to fully account for the provided overcollateralisation. We are not aware of plans that would significantly change the risk profile or reduce available overcollateralisation to levels that would no longer support the current rating uplift.

Figure 3: Available overcollateralisation versus rating-supporting level



Source: Scope Ratings

Other risk considerations

Counterparty risk mitigated by alignment of interests between stakeholders

The rated covered bonds have counterparty exposures to the issuer, as well as to the issuer's parent as loan originator, servicer, bank account provider and paying agent. However, if a regulator were to intervene, we believe the strong alignment of interests between the bank and the covered bond holders would prevent any negative impact. We also take a positive view that collections are generally done via direct debit, allowing for a relatively swift redirection of payments if needed.

Country risk not affecting the ratings

Sovereign risk does not limit the ratings of TSBB's mortgage covered bonds. We believe the risks of an institutional framework meltdown, legal insecurity or currency-convertibility problems are currently remote.

No impact from ESG

We have not directly included ESG aspects into the rating of covered bonds issued by TSBB. The issuer has no specific ESG underwriting guidelines which provide for positive or negative adjustments to terms and conditions of a mortgage loan in case minimum ESG conditions are met.

Environmental aspects, in particular Norwegian energy efficiency standards are, as typical for most banks, often not recorded in the bank's main underwriting databases. We therefore have not been able to perform a specific analysis of environmental or social factors and their impact on the cover assets probability of default or their recovery proceeds. At the same time, we indirectly include environmental aspects as collateral valuations do reflect the condition of the collateral.

The bank follows environmental, sustainability and corporate governance related guidelines. The bank also operates an endowment scheme from which it regularly donates for regional charitable purposes. TSB actively seeks to contribute to growth and development in the region which indirectly strengthens the bank's local market position.

Summary of covered bond characteristics

Reporting date	30 June 2019	30 Sept 2018
Issuer name	Totens Sparebank Boligkreditt	
Country	Norway	
Covered bond name	Obligasjoner med fortrinnsrett (Norwegian mortgage covered bonds)	
Covered bond legal framework	Norwegian legal covered bond framework	
Cover pool type	Residential mortgage loans	
Composition	Residential = 91.4%	Residential = 90.8%
	Substitute = 8.6%	Substitute = 9.2%
Issuer rating	A-/Stable	A-/Stable
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Soft bullets	Soft bullets
Cover pool currencies	NOK (100%)	NOK (100%)
Covered bond currencies	NOK (100%)	NOK (100%)
Fundamental cover pool support	5	5
Maximum achievable covered bond uplift	8	8
Potential covered bond rating buffer	2	2
Cover pool (NOK bn)	2.76	2.08
thereof, substitute assets (NOK bn)	0.24	0.21
Covered bonds (NOK bn)	2.28	1.71
Overcollateralisation: current / legal minimum	21.2% / 2%	21.9% / 2%
Overcollateralisation to support current rating	4%	8%
Overcollateralisation upon a one-notch issuer downgrade	5.5%	9%
Weighted average life of assets	12.5 years	12 years
Weighted average life of liabilities [1]	4.1 years	2.6 years
Number of loans	1,713	1,452
Average loan size (NOK m)	1.5	1.4
Top-10 residential	2.9%	3.9%
Interest rate type – assets	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%
Interest rate type – liabilities	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%
Weighted average LTV (indexed)	55.2%	53.1%
Geographic split (top 3)	Oppland = 44%	Oppland = 47%
	Akershus = 26%	Akershus = 26%
	Hedmark = 15%	Hedmark = 12%
Default measure	Inverse Gaussian/ Non-Parametric	Inverse Gaussian/ Non-Parametric
Weighted average default rate (mortgage/substitute)	9.5%/ 0.21%	9.5%/ 0.11%
Weighted average coefficient of variation (mortgage/substitute)	50%/ 1,353%	50%/ 1,375%
Weighted average recovery assumption (D0/D6)[2]	97.3% / 77.7%	99.0% / 66.5%
Share of loans > three months in arrears (NPL)	0.04%	0.04%
Interest rate stresses (max./min.; currency-dependent)	-1 to 10%	-1 to 10%
FX stresses (max./min.; currency-dependent)	n/a	n/a
Max liquidity premium	150bps	150bps
Average servicing fee	25bps	25bps

[1] Including the 12-month extension
[2] D0 and D8 denote the stresses commensurate with the rating distance between our credit view on the issuer and the covered bond ratings.

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